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Department of the Treasury

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PLR-139549-07

Date:

September 29, 2008

Re:

LEGEND:

Grantor	=
Trust	=
Trust 1	=
Trust 2	=
Agreement	=
Year	=
Date 1	=
Date 2	=
Date 3	=
Date 4	=
A	=
B	=
C	=
D	=
E	=
F	=
G	=
H	=
J	=
K	=
L	=
M	=
Entity 1	=
Entity 2	=

Entity 3 =
Entity 4 =
Company =
Referee =
State =
Statute 1 =
Statute 2 =
Court =

Dear :

This is in response to the June 25, 2008 letter and prior correspondence requesting rulings on the income, estate, gift, and generation-skipping transfer tax consequences of the proposed modifications of Trust 1 and Trust 2.

The facts submitted are as follows. Trust was created by Grantor in Year (before September 26, 1985) to benefit one of her children, K, and his issue. On Date 1, pursuant to a settlement agreement ("Agreement") and a court order, Trust was partitioned into several trusts, including Trust 1 and Trust 2, which are the subject of this ruling. Date 1 is before September 26, 1985. Trust 1 and Trust 2 are administered under the laws of State. Trust 1 and Trust 2 will be referred to collectively as "the Trusts."

Under Article IV of Trust and Article 2 of the Agreement, the entire net income of Trust 1 and Trust 2 is to be paid to G's issue living from time to time, by right of representation. Under Article VI, Paragraph (2) of the Trust and Article 4, Paragraph (a) of the Agreement, the Trusts will terminate on the death of the last to die of F and H. The current income beneficiaries of Trust 1 and Trust 2 are A, B, C, D, and E, who are the issue of G. Under Article VII of Trust and Article 4, Paragraph (b) of the Agreement, on termination of the Trusts, the property of Trust 1 is to be distributed to the then living issue of G, per stirpes, and the property of Trust 2 is to be distributed to the then living issue of H, per stirpes.

Entity 1 is the trustee ("Trustee 1") of Trust 1. Trustee 1 and Entity 2 ("Trustee 2") are the trustees of Trust 2. Trustee 1 and Trustee 2 will be referred to collectively as "the Trustees." Entity 1 is owned by the income beneficiaries of the Trusts. Entity 2 is owned by the presumptive remaindermen of Trust 2. Trust 2 is administered by a majority vote in which Trustee 1 has two votes and Trustee 2 has one vote.

Statutes

Effective Date 2, State enacted Statute 1 which provides that a trustee may adjust

between principal and income to the extent the trustee considers necessary if the trustee invests and manages the trust assets as a prudent investor, and the terms of the trust describe the amount to be distributed to a beneficiary by referring to the trust's income. In deciding whether and to what extent to exercise this power, a trustee shall consider all factors relevant to the trust and its beneficiaries, including certain listed factors.

Under Statute 1, a trustee may not make an adjustment: (i) if possessing or exercising the power to make an adjustment causes a person to be treated as the owner of all or part of the trust for income tax purposes, and the person would not be treated as the owner if the trustee did not possess the power to make an adjustment; (ii) if possessing or exercising the power to make an adjustment causes all or part of the trust assets to be included for estate tax purposes in the estate of a person who has the power to remove a trustee or appoint a trustee, or both, and the assets would not be included in the estate of the person if the trustee did not possess the power to make an adjustment; (iii) if the trustee is a beneficiary of the trust; or (iv) if the trustee is not a beneficiary, but the adjustment would benefit him directly or indirectly.

Statute 2 provides that, in exercising the power to adjust under Statute 1, a fiduciary shall administer a trust or estate impartially, based on what is fair and reasonable to all the beneficiaries, except to the extent that the terms of the trust clearly manifest an intention that the fiduciary shall or may favor one or more of the beneficiaries.

Proposed Modifications

On Date 4, the Trustees petitioned Court to modify the Trusts. It is represented that the petition, as amended, will pray for a Court order:

- (i) appointing Entity 4, a newly-formed limited liability company, as a disinterested Special Trustee for the limited purpose of exercising the power to make adjustments between principal and income (the "Adjustment Power") pursuant to Statute 1;
- (ii) conferring upon the Special Trustee the limited power to exercise the Adjustment Power on an annual (or more frequent basis) after taking into consideration all factors relevant to the Trusts and the beneficiaries, including the factors enumerated in Statute 1 and the Special Trustee shall not have any other trustee powers over the Trusts, all of which are reserved in the Trustees;
- (iii) entitling the Special Trustee to indemnification by the Trusts against all claims, liabilities, and expenses, resulting from the possession or exercise of the Adjustment Power;
- (iv) entitling the Special Trustee to an annual fixed fee payable from the

- assets of the Trusts in such amount as determined by agreement between the Trustees and the Special Trustee and such compensation will not be related to the exercise of the Adjustment Power;
- (v) conferring each member of the Special Trustee with the power to approve the transfer of any membership interest by the other member or to appoint a successor member to fill any vacancy in the membership of the Special Trustee caused by the redemption of a membership interest;
 - (vi) that, as will be specifically provided in the Entity 4 Operating Agreement, in no event shall any of the following individuals or entities become a successor member of the Special Trustee: (a) a lineal descendant of K; (b) a legal entity that is owned in whole or in part by a lineal descendant of K or of which a lineal descendant of K has voting control; (c) any individual or legal entity that would otherwise be disqualified from exercising the power to adjust between income and principal under the limitations of Statute 1; or (d) a related or subordinate party (as defined in § 672(c) of the Internal Revenue Code) to Grantor or any beneficiary;
 - (vii) that the Special Trustee may be removed (and, if desired, replaced) for any reason or for no reason, and with or without court approval, by Trustee 1 and Trustee 1 may appoint any person or entity qualified to serve as the replacement or successor Special Trustee of the Trusts, subject to the same limitations imposed in (vii); and
 - (viii) modifying the definition of “annual gross income” for purposes of the trustee fee calculation to take into account any adjustments made between principal and income of the Trusts.

The income beneficiaries and the adult vested and contingent beneficiaries consented to the proposed modifications to the Trusts. The Court order is dependent upon receipt of a favorable private letter ruling from this office.

Entity 4 Operating Agreement and Special Trustee

The Entity 4 Operating Agreement (the “Operating Agreement”) was entered into on Date 4 by and between Entity 4 and individuals, J and M. It is represented that the Operating Agreement, as amended, will provide that:

- (i) The purpose of Entity 4 is to act as Special Trustee for the Trusts in exercising the power to adjust between principal and income pursuant to Statute 1;
- (ii) Entity 4 shall have two members, who must be selected from the following classes of individuals: (a) One member must hold a position of an officer, director, manager, partner or member of the Trusts’ outside investment consultant, law firm, or accounting firm (“Professional Service Provider”) (the “PSP member”), and (b) The other member must hold the position of Chief Investment Officer, Chief Operating Officer, General

- Counsel, Chief Financial Officer, or Treasurer of Entity 3, or a successor to Entity 3 (the “CIO member”);
- (iii) The following individuals and entities may not be a member: (a) a lineal descendant of K; (b) a legal entity that is owned in whole or in part by a lineal descendant of K or of which a lineal descendant of K has voting control; (c) any individual or legal entity that would otherwise be disqualified from exercising the power to adjust between income and principal under the limitations of Statute 1; or (d) a related or subordinate party (as defined in § 672(c)) to Grantor or any beneficiary;
 - (iv) The initial PSP member will be J, Chief Investment Officer of Company, and the initial CIO member will be M, Senior Managing Director of Entity 3;
 - (v) A member’s interest must be redeemed if certain events occur, such as his death or resignation, and the remaining member will appoint the successor member to fill the vacancy, subject to Trustee 1’s veto right, and if both members are redeemed simultaneously, each member is to designate a series of individuals who satisfy the membership criteria to act as nominal successor member. Once two nominal successor members are in place, they will then select permanent successor members, subject to Trustee 1’s veto right;
 - (vi) A member may transfer his interest only with the prior approval of the remaining member and subject to Trustee 1’s veto right;
 - (vii) The PSP member and CIO member will meet at least once a year and decide whether to exercise the Adjustment Power. Only the PSP member may propose an adjustment. If the CIO member agrees, the adjustment will be made. If the CIO member does not agree, creating a tie-breaker, an independent third person (the “Referee”) will make the decision or, in the alternative, the Referee may present a revised proposal which, to take effect, must be approved by the PSP member or the CIO member. If one year has elapsed, and the PSP member has not made an adjustment proposal, the Referee may initiate a proposal which, to take effect, must be approved by the PSP member or the CIO member;
 - (viii) The Referee may not be related or subordinate (as defined in § 672(c)) to Grantor or any beneficiary of the Trusts, and must be disinterested (as determined under State law). The Referee must be (i) a person with at least 15 years of professional experience in trust administration law, accounting, investment management, or private wealth management, or (ii) another professional service provider. L will be the initial Referee;
 - (ix) The Referee may be removed by either member at any time, except during a time that a tie-breaker situation has occurred. The Referee may be appointed only by the PSP member, although the designation is subject to the CIO member’s consent, which may not be unreasonably withheld.

It is represented that no beneficiary is acting as a PSP member. As stated above, J is the Senior Managing Director of Company. Company is the Trusts' investment consultant. Company is neither owned nor controlled by the beneficiaries of the Trusts and Company will not own or control any interest in the Special Trustee. As stated above, M is the Chief Investment Office of Entity 3. Entity 3 is owned by the income beneficiaries and presumptive remaindermen of the Trusts. However, neither Entity 3 nor any beneficiary of the Trusts may own or control the Special Trustee. It is represented that L, the Referee, is not related or subordinate to Grantor or any of the beneficiaries of the Trusts.

It is represented that there have been no additions, actual or constructive, to the Trusts after September 25, 1985.

Rulings requested

You have requested the following rulings:

- (1) The Special Trustee's possession and exercise of the Adjustment Power, pursuant to the proposed modifications of the Trusts, will not constitute a sale, exchange, or other disposition of the Trusts' assets and will not result in the recognition of any gain or loss by the Trusts or the beneficiaries for income tax purposes.
- (2) If the Special Trustee makes an adjustment between principal and income pursuant to the proposed modifications of the Trusts, any resulting distributions of capital gain to the income beneficiaries will be treated as income for all purposes of Subparts A through D, Part I, Subchapter J, Chapter 1 of the Code.
- (3) The Special Trustee's possession and exercise of the Adjustment Power, pursuant to the proposed modifications of the Trusts, will not cause any beneficiary, the Special Trustee, or any member of the Special Trustee to be treated as the owner of any part of the Trusts' assets under § 678.
- (4) If a member's interest in the Special Trustee is redeemed, and the remaining member selects a successor to the vacancy, Trustee 1's possession of a power to veto the appointment of that person will not cause a beneficiary, the Special Trustee, or any member of the Special Trustee to be treated as the owner of any part of the Trusts' assets under § 678.
- (5) The proposed modifications of the Trusts to provide for the appointment of the Special Trustee, the amendment to the trustee compensation provisions, and the Special Trustee's Adjustment Power will not adversely affect the Trusts' status as exempt from GST tax.

(6) The Special Trustee's possession and exercise of the Adjustment Power, pursuant to the proposed modifications of the Trust, will not constitute a taxable transfer by any beneficiary of the Trusts' for gift tax purposes.

(7) Neither the Special Trustee's Adjustment Power nor Trustee 1's power to remove and replace the Special Trustee pursuant to the proposed modifications of the Trusts will cause any part of the Trusts' assets to be included in a beneficiary's estate under § 2041.

(8) If a member's interest in the Special Trustee is redeemed in a mandatory redemption, and the remaining member selects a successor for the vacancy, Trustee 1's power to veto the appointment pursuant to the proposed modifications of the Trusts will not cause any part of the Trusts' assets to be included in a beneficiary's estate under § 2041.

Ruling 1

Section 61(a)(3) provides that gross income includes gains derived from dealings in property. Section 61(a)(15) provides that gross income includes income from an interest in a trust.

Section 1.643(b)-1 of the Income Tax Regulations provides that a switch between methods of determining trust income authorized by state statute will not constitute a recognition event for purposes of § 1001. Additionally, § 1.643(b)-1 provides that an allocation to income of all or part of the gains from the sale or exchange of trust assets will generally be respected if the allocation is made either pursuant to the trust terms and applicable local law or pursuant to a reasonable and impartial exercise of a discretionary power granted to the fiduciary by applicable local law or by the trust terms if not prohibited by applicable local law.

Section 1001(a) provides that the gain from the sale or other disposition of property shall be the excess of the amount realized over the adjusted basis provided in § 1011 for determining gain, and the loss shall be the excess of the adjusted basis provided in § 1011 for determining loss over the amount realized.

Section 1001(b) provides that the amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of the property (other than money received). Under § 1001(c), except as otherwise provided in subtitle A, the entire amount of gain or loss, determined under § 1001, on the sale or exchange of property shall be recognized.

Section 1.1001-1(a) provides that the gain or loss realized from the conversion of property to cash, or from the exchange of property for other property differing

materially either in kind or in extent, is treated as income or loss sustained.

In Cottage Savings Ass'n v. Commissioner, 499 U.S. 554 (1991), a financial institution exchanged its interests in one group of residential mortgage loans for another lender's interest in a different group of residential mortgage loans. The two groups of mortgages were considered "substantially identical" by the agency that regulated the financial institution. The issue presented was whether a sale or exchange had taken place resulting in a realization of gain or loss under § 1001. The Supreme Court concluded that § 1.1001-1 reasonably interprets § 1001 and stated that an exchange of property gives rise to a realization event under § 1001(a) if the properties exchanged are "materially different." 499 U.S. at 560-61. In defining what constitutes a "material difference" for purposes of § 1001(a), the Court stated that properties are "different" in the sense that is "material" so long as their respective possessors enjoy legal entitlements that are different in kind or extent. 499 U.S. at 564-55. The Court held that mortgage loans made to different obligors and secured by different homes did embody distinct legal entitlements, and that the taxpayer realized losses when it exchanged interests in the loans. 499 U.S. at 566.

Under State law, a trustee may adjust between principal and income if the trustee invests and manages as a prudent investor and the amount that must be distributed to a beneficiary is determined based on the trust's income. Statute 1. Additionally, Statute 1 provides guidelines and restrictions on the trustee's power to make adjustments between principal and income.

Provided the Court approves the petition for modification, it is consistent with Cottage Savings to find that the interests of the beneficiaries of the Trusts will not differ materially from their interests prior to the judicial modification. Because Statute 1 grants the Trustees the power to administer the Trusts in the same manner as proposed in the modifications, the modifications are not treated as an exchange of interests by the beneficiaries or the Trusts. Except for the changes described above, all other provisions will be identical. Accordingly, based upon the facts submitted and representations made, we conclude that the Special Trustee's possession and exercise of the Adjustment Power, pursuant to the proposed modifications to the Trusts, will not result in a material difference in kind or extent of the legal entitlements enjoyed by the beneficiaries and, therefore, no gain or loss will be realized by the beneficiaries or the Trusts for purposes of § 1001.

Ruling 2

Section 643(b) defines the term income for purposes of subparts A through D, part I, subchapter J, chapter 1 of the Code. Specifically, § 643(a) provides that the term "income," when not preceded by the words "taxable," "distributive net," "undistributed net," or "gross" means the amount of income of the estate or trust for the taxable year determined under the terms of the governing instrument and

applicable local law. Items of gross income constituting extraordinary dividends or taxable stock dividends which the fiduciary, acting in good faith, determines to be allocable to corpus under the terms of the governing instrument and applicable local law, shall not be considered income.

Section 1.643(b)-1 provides that, for purposes of subparts A through D, part I, subchapter J, chapter 1 of the Code, "income" means the amount of income of an estate or trust for the taxable year determined under the terms of the governing instrument and applicable local law. Section 1.643(b)-1 further provides that an allocation of amounts between income and principal pursuant to applicable local law will be respected if local law provides for a reasonable apportionment between the income and remainder beneficiaries of the total return of the trust for the year, including ordinary and tax-exempt income, capital gains, and appreciation. For example, a state statute that permits the trustee to make adjustments between income and principal to fulfill the trustee's duty of impartiality between the income and remainder beneficiaries is generally a reasonable apportionment of the total return of the trust. Generally, these adjustments are permitted by state statutes when the trustee invests and manages the trust assets under the state's prudent investor standard, the trust describes the amount that may or must be distributed to a beneficiary by referring to the trust's income, and the trustee, after applying the state statutory rules regarding the allocation of receipts and disbursements to income and principal, is unable to administer the trust impartially. Allocations pursuant to methods prescribed by such state statutes for apportioning the total return of a trust between income and principal will be respected regardless of whether the trust provides that the income must be distributed to one or more beneficiaries or may be accumulated in whole or in part, and regardless of which alternate permitted method is actually used, provided the trust complies with all requirements of the state statute for switching methods.

Under the proposed modifications of Trust 1 and Trust 2, the Special Trustee has the power to make adjustments between principal and income. Accordingly, based upon the facts submitted and representations made, we conclude that, if the Special Trustee makes an adjustment between principal and income in accordance with the proposed modifications and in accordance with and pursuant to Statute 1, any resulting distribution of capital gain to the income beneficiaries will be treated as income for all purposes of subparts A through D, part I, subchapter J, chapter 1 of the Code.

Rulings 3 & 4

Section 678(a) provides that a person other than the grantor shall be treated as the owner of any portion of a trust with respect to which such person has a power exercisable solely by himself to vest the corpus or income therefrom in himself.

Section 1.678(a)-1 provides that where a person other than the grantor of a trust has a power exercisable solely by himself to vest the corpus or the income of any portion of a testamentary or inter vivos trust in himself, he is treated under § 678(a) as the owner of that portion, except as provided in § 678(b) (involving taxation of the grantor) and § 678(c) (involving an obligation of support).

The Special Trustee's possession and exercise of the power to adjust between principal and income pursuant to the proposed modification of the Trusts will not cause any beneficiary, the Special Trustee, or any member of the Special Trustee to be treated as the owner of any portion of the Trusts' assets under § 678. Under the proposed modification of the Trusts, no person has a power exercisable solely by himself to vest the corpus or the income therefrom in himself. No beneficiary has the power to make adjustments between principal and income. The Operating Agreement for the Special Trustee requires that the following individuals and entities are prohibited from becoming a member of the Special Trustee: (i) any lineal descendant of K.; (ii) any legal entity that is owned in whole or in part by a lineal descendant of K or of which a lineal descendant of K has voting control; (iii) any individual or legal entity that would otherwise be disqualified from exercising the power to adjust between income and principal under the limitations of Statute 1; or (iv) a related or subordinate party (within the meaning of § 672(c)) to Grantor or any of the beneficiaries of the Trusts. Therefore, the Special Trustee may not vest corpus or income in itself or its members.

If a membership interest in the Special Trustee is redeemed pursuant to the mandatory redemption events and the remaining member selects a successor member to fill the vacancy in the membership of the Special Trustee, Trustee 1's power to veto the appointment of said successor member will not cause a beneficiary, the Special Trustee, or any member of the Special Trustee to be treated as the owner of any portion of the Trusts' assets under § 678. The Court order will specifically provide that Trustee 1 may remove and replace the Special Trustee with a successor Special Trustee provided that the following individuals and entities may not be appointed as a successor Special Trustee: (i) any lineal descendant of K; (ii) any legal entity that is owned in whole or in part by a lineal descendant of K or of which a lineal descendant of K has voting control; (iii) any individual or legal entity that would otherwise be disqualified from exercising the power to adjust between income and principal under the limitations of Statute 1; or (iv) a related or subordinate party (within the meaning of § 672(c)) to Grantor or any of the beneficiaries of the Trusts. Therefore, neither Trustee 1 nor the Special Trustee may vest corpus or income in itself or its members.

Based on the facts submitted and representations made, we conclude that the Special Trustee's possession and exercise of the Adjustment Power, pursuant to the proposed modifications to the Trusts and in accordance with Statute 1, will not cause any beneficiary, the Special Trustee, or any member of the Special Trustee to be treated as the owner of any part of the Trusts' assets under § 678. Further,

we conclude that, if a member's interest in the Special Trustee is redeemed, and the remaining member selects a successor to the vacancy, Trustee 1's possession of a power to veto the appointment of that successor member will not cause a beneficiary, the Special Trustee, or any member of the Special Trustee to be treated as the owner of any part of the Trusts' assets under § 678, provided such power is in accordance with and pursuant to the proposed modifications of the Trusts and Statute 1.

Issue 5

Section 2601 imposes a tax on every generation-skipping transfer ("GST") made after October 26, 1986.

Under § 1433(a) of the Tax Reform Act of 1986 (Act) and § 26.2601-1(a) of the Generation-Skipping Transfer Tax Regulations, the GST tax is generally applicable to GSTs made after October 22, 1986. However, under § 1433(b)(2)(A) of the Act and § 26.2601-1(b)(1)(i), the GST tax does not apply to a transfer under a trust that was irrevocable on September 25, 1985, but only to the extent that the transfer is not made out of corpus added to the trust after September 25, 1985 (or out of income attributable to corpus so added). Under § 26.2601-1(b)(1)(ii), any trust in existence on September 25, 1985, will be considered irrevocable unless the decedent had a power that would have caused inclusion of the trust in his or her gross estate under § 2038 or 2042, if the decedent had died on September 25, 1985.

Section 26.2601-1(b)(4)(i) provides rules for determining when a modification, judicial construction, settlement agreement, or trustee action with respect to a trust that is exempt from the GST tax under § 26.2601-1(b)(1), (2), or (3) will not cause the trust to lose its exempt status. Under the regulation, unless specifically provided otherwise, these rules are applicable only for purposes of determining whether an exempt trust retains its exempt status for GST tax purposes. Thus (unless specifically noted), the rules do not apply in determining, for example, whether the transaction results in a gift subject to gift tax, or may cause the trust to be included in the gross estate of a beneficiary, or may result in the realization of gain for purposes of § 1001.

Section 26.2601-1(b)(4)(i)(D)(1) provides that a modification of the governing instrument of an exempt trust, including a trustee distribution, settlement, or construction (that does not satisfy § 26.2601-1(b)(4)(i)(A), (B), or (C)) by judicial reformation, or nonjudicial reformation that is valid under applicable state law, will not cause an exempt trust to be subject to the provisions of chapter 13, if the modification does not shift a beneficial interest in the trust to any beneficiary who occupies a lower generation (as defined in § 2651) than the person or persons who held the beneficial interest prior to the modification, and the modification does not

extend the time for vesting of any beneficial interest in the trust beyond the period provided for in the original trust.

Section 26.2601-1(b)(4)(i)(D)(2) provides that a modification of an exempt trust will result in a shift in beneficial interest to a lower generation beneficiary if the modification can result in either an increase in the amount of a GST transfer or the creation of a new GST transfer. To determine whether a modification of an irrevocable trust will shift a beneficial interest in a trust to a beneficiary who occupies a lower generation, the effect of the instrument on the date of the modification is measured against the effect of the instrument in existence immediately before the modification. If the effect of the modification cannot be immediately determined, it is deemed to shift a beneficial interest in the trust to a beneficiary who occupies a lower generation (as defined in § 2651) than the person or persons who held the beneficial interest prior to the modification.

A modification that is administrative in nature that only indirectly increases the amount transferred (for example, by lowering administrative costs or income taxes) will not be considered to shift a beneficial interest in the trust. In addition, administration of a trust in conformance with applicable local law that defines the term income as a unitrust amount (or permits a right to income to be satisfied by such an amount) or that permits the trustee to adjust between principal and income to fulfill the trustee's duty of impartiality between income and principal beneficiaries will not be considered to shift a beneficial interest in the trust, if applicable local law provides for a reasonable apportionment between the income and remainder beneficiaries of the total return of the trust and meets the requirements of § 1.643(b)-1.

Section 26.2601-1(b)(4)(i)(E), Example 12 considers a situation where, in 1980, the Grantor, a resident of State X, establishes an irrevocable trust for the benefit of Grantor's child, A, and A's issue. The trust provides that trust income is payable to A for life and upon A's death, the remainder passes to A's issue per stirpes. In 2002, State X amends its income and principal statute to permit the trustee to make adjustments between income and principal when the trustee invests and manages the trust assets under the state's prudent investor standard, the trust describes the amount that shall or must be distributed to a beneficiary by referring to the trust's income, and the trustee after applying the state statutory rules regarding allocation of receipts between income and principal is unable to administer the trust impartially. The provision permitting the trustees to make these adjustments is effective in 2002 for trusts created at any time. The trustee invests and manages the trust assets under the state's prudent investor standard, and pursuant to authorization in the statute. The trustee allocates receipts between the income and principal accounts in a manner to ensure the impartial administration of the trust. The example concludes that the administration of the trust in accordance with the statute will not be considered to shift any beneficial

interest in the trust. Therefore, the trust will not be subject to the provisions of chapter 13. Further, no trust beneficiary will be treated as having made a gift for federal gift tax purposes, and neither the trust nor any trust beneficiary will be treated as having made a taxable exchange for federal income tax purposes.

In the instant case, Trust 1 and Trust 2 were irrevocable on September 25, 1985, and it is represented that there have been no additions made after September 25, 1985. The Trustees petitioned Court to appoint a Special Trustee with the power to make adjustments between principal and income pursuant to Statute 1, a statute similar to that described in § 26.2601-1(b)(4)(i)(D)(2) and § 26.2601-1(b)(4)(i)(E), Example 12. Therefore, the proposed administration of Trust 1 and Trust 2 in accordance with Statute 1 and Statute 2 will not be considered to shift any beneficial interest in the Trusts for GST purposes. Accordingly, based on the facts submitted and representations made, we conclude that, if the Special Trustee makes adjustments between principal and income in accordance with the proposed modifications and in accordance with and pursuant to Statute 1, the proposed modifications of the Trusts to provide for the appointment of the Special Trustee and the Special Trustee's Adjustment Power will not adversely affect the Trusts' status as exempt from GST tax. Further, we conclude that the amendment to the trustee compensation provisions is administrative in nature and, therefore, is not considered to shift a beneficial interest in the Trusts. Accordingly, we conclude that the amendment will not adversely affect the Trusts' status as exempt from GST tax.

Issue 6

Section 2501 imposes a tax on the transfer of property by gift during the calendar year by any individual.

Section 2511 provides that the gift tax applies whether the transfer is in trust or otherwise, whether the gift is direct or indirect and whether the property is real or personal, tangible or intangible.

As set forth above under Issue 5, § 26.2601-1(b)(4)(i)(E), Example 12 concludes that where a trustee administers a trust in accordance with a state statute that permits the trustee to make adjustments between income and principal, no trust beneficiary will be treated as having made a gift for federal gift tax purposes.

Section 2514(b) provides that the exercise or release of a general power of appointment shall be deemed a transfer of property by the individual possessing the power. Section 2514(c) provides that the term "general power of appointment" means a power that is exercisable in favor of the individual possessing the power, his estate, his creditors, or the creditors of his estate.

Section 25.2514-1(b)(1) of the Gift Tax Regulations provides, in part, that a power in a donee to remove or discharge a trustee and appoint himself may be a power of appointment. For example, if, under the terms of a trust instrument, the trustee or his successor has the power to appoint the principal of the trust for the benefit of individuals including himself, and A, another person, has the unrestricted power to remove or discharge the trustee at any time and appoint any other person including himself, A is considered as having a power of appointment.

In this case, the Special Trustee will have the power to make adjustments between income and principal of the Trusts. The CIO member of the Special Trustee is the Senior Managing Director of Entity 3, which is owned by the income beneficiaries and presumptive remaindermen of the Trusts. However, Entity 3 and the beneficiaries of the Trusts may not own or control the Special Trustee. Further, the provisions of the Operating Agreement preclude the CIO member from making a unilateral decision with respect to adjustments that may be treated as a power of appointment under § 2514. While Trustee 1, which has the power to replace and remove the Special Trustee, is owned by the income beneficiaries, that power is restricted and, among other restrictions, Trustee 1 may not appoint a Special Trustee that is related or subordinate (as defined in § 672(c)) to Grantor or any beneficiary of the Trusts. Accordingly, based on the facts submitted and representations made, we conclude that the Special Trustee's possession and exercise of the Adjustment Power, in accordance with the proposed modifications and in accordance with and pursuant to Statute 1, will not constitute a taxable transfer by any beneficiary of the Trusts for gift tax purposes.

Issues 7 and 8

Section 2041(a)(2) provides that the value of the gross estate includes the value of all property to the extent of any property with respect to which the decedent has at the time of death a general power of appointment. Section 2041(b) defines the term "general power of appointment" as a power which is exercisable in favor of the decedent, his estate, his creditors, or the creditors of his estate, subject to certain exceptions.

Section 20.2041-1(b)(1) of the Estate Tax Regulations provides, in part, that the term "power of appointment" includes all powers which are in substance and effect powers of appointment regardless of the nomenclature used in creating the power and regardless of local property law connotations. A power in a donee to remove or discharge a trustee and appoint himself may be a power of appointment.

Rev. Rul. 95-58, 1995-2 C.B. 191, holds that a grantor's reservation of an unqualified power to remove a trustee and to appoint an individual or corporate successor trustee that is not related or subordinate, within the meaning of § 672(c), to the grantor, is not considered a reservation of the trustee's discretionary powers

of distribution over the property transferred by the grantor to the trust. Accordingly, the trust corpus is not includible in the grantor's gross estate under §§ 2036 or 2038. The ruling notes that the Eighth Circuit in Estate of Vak v. Commissioner, 973 F.2d 1409 (8th Cir. 1992), concluded that the grantor had not retained dominion and control over assets transferred to the trust by reason of his power to remove and replace the trustee with a party that was not related or subordinate to the grantor. The court held that under § 25.2511-2(c), the grantor made a completed gift when he created the trust and transferred assets to it, and the trust assets were not includible in his gross estate.

Under § 672(c), the term "related or subordinate party" means a nonadverse party who is: (1) the grantor's spouse if living with the grantor; (2) the grantor's father, mother, issue, brother, or sister; (3) an employee of the grantor; (4) a corporation or an employee of a corporation in which the stock holdings of the grantor and the trust are significant from the viewpoint of voting control; or (4) a subordinate employee of a corporation in which the grantor is an executive.

In the proposed modification, proposals to make adjustments may be made only by the PSP member and, in limited circumstances, the Referee. Both the PSP member and the Referee must not be related or subordinate, within the meaning of § 672(c), to Grantor or any beneficiary of the Trusts. In addition, they must be disinterested, as determined under State law. See Statute 1.

The CIO member is the Senior Managing Director of Entity 3, and, thus, an employee of the income beneficiaries of the Trusts. However, the CIO member's authority is limited. He may only consent or refuse to consent to a proposal to make an adjustment made by the PSP member or the Referee. If the CIO member does not consent to the PSP member's proposal, he can be overruled by the Referee's vote of consent. Likewise, if the CIO member does not consent to a proposal to make an adjustment made by the Referee, he can be overruled by the PSP member's vote of consent.

Trustee 1 may remove and replace the Special Trustee and may veto the designation of successor members of the Special Trustee. However, any successor Special Trustee cannot be related or subordinate, within the meaning of § 672(c), to Grantor or any beneficiary of the Trusts, and must be disinterested (as determined under State law). Further, all proposals to make adjustments must be instituted and agreed to by the PSP member and/or the Referee. In effect, these two disinterested persons will control the exercise of the Adjustment Power.

In view of the requirements imposed with respect to the appointment of a Special Trustee, the PSP member, and the Referee, Trustee 1's powers to remove and replace the Special Trustee and to veto a Special Trustee member's replacement are not considered powers to appoint the Trusts' property, within the meaning of

§ 2041. Therefore, no beneficiary will be considered as having a general power of appointment under § 20.2041-1(b)(1) by reason of those powers to be held by Trustee 1.

Accordingly, based on the facts submitted and representations made by the Trusts, we conclude that the Special Trustee's Adjustment Power, pursuant to the proposed modifications and Statute 1, will not cause any portion of the Trusts' assets to be included in a beneficiary's gross estate under § 2041 and Trustee 1's powers to remove and replace the Special Trustee and veto the appointment of a successor Special Trustee member, pursuant to the proposed modifications and Statute 1, will not cause any portion of the Trusts' assets to be included in a beneficiary's gross estate under § 2041.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. Further, no opinion is expressed or implied concerning whether J, M. or L are related or subordinate, as defined in § 672(c), to Grantor or any of the beneficiaries of the Trusts,

This ruling is directed only to the taxpayers requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent. In accordance with the power of attorney on file with this office, a copy of this letter is being sent to your authorized representative.

Sincerely yours,

Lorraine E. Gardner
Senior Counsel, Branch 4
Office of Associate Chief Counsel
(Passthroughs and Special Industries)

Enclosures: Copy for § 6110 purposes